

**BEFORE THE
UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON ENERGY AND COMMERCE
SUBCOMMITTEE ON ENERGY AND AIR QUALITY**

**Testimony of
GERALD A. NORLANDER**

For

**NATIONAL ASSOCIATION OF STATE
UTILITY CONSUMER ADVOCATES**

**Regarding Energy Policy Act of 2005
Ensuring Jobs for Our Future with Secure and Reliable Energy**

Washington, DC

February 16, 2005

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**Testimony of Gerald A. Norlander for National Association of
State Utility Consumer Advocates
Before the House Subcommittee on Energy and Air Quality
Hearing on Proposed Energy Policy Act of 2005
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Summary of Testimony

The primary purpose of the Federal Power Act of 1935 (FPA) is the protection of consumers, and so proposals to change it should be measured by whether they add meaningful protections or erode the existing statutory bond with consumers -- that all rates demanded and charged be just and reasonable. Taken as a whole, the draft bill does not assure the demonstrable benefits or meaningful added protections that would make its enactment into law a value proposition for consumers. Indeed, the bill includes unnecessary measures that could increase rates and add new risks for consumers.

The 2005 draft does not address NASUCA's concerns with H.R. 6, previously identified in 2003, and thus NASUCA remains opposed to the latest iteration, which contains many of the same provisions. The bill may increase consumer rates unnecessarily by prescribing rate increases for electricity transmission lines and facilities beyond a level that is just and reasonable. FERC already possesses sufficient flexibility to set rates for transmission and to determine how rate burdens will be allocated. The bill contains incidental allusions to deregulated market-based rates, contract sanctity, and private market rate setting mechanisms, possibly altering the existing bond of the FPA that no rate will be charged that is not subject to FERC review for reasonableness before it is charged. Yet the bill does not establish any criteria for granting or denying market-based rates, it does not grant sufficient market oversight powers that would be needed by a market regulator, it does not address market manipulation fully

and it does not provide full remedies to consumers when there is market abuse. In light of recent instances of energy market manipulation, holding company abuses, FERC's inability to provide timely and complete consumer remedies when the market rates it has allowed are unreasonable, and the possibility of further industry consolidation, it is clear that consumers need greater, not less, statutory protection from the exercise of utility market power and holding company structures. For these reasons, NASUCA concludes that the proposals to modify the Electricity Title of the FPA now under consideration are not in the interests of utility consumers.

Since NASUCA's last testimony in 2003, public concern about electric system reliability issues has grown. The importance of clear, strong reliability standards backed by laws and rules sufficient to deter their breach is underscored by the widespread U.S. - Canada blackout of August 2003, and by the recent revelation that a power plant was intentionally shut down in order to create scarcity and drive California wholesale electricity prices higher. Whether or not Congress agrees upon a comprehensive energy bill, the reliability portion of the proposed legislation should be enacted.

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Chairman Hall And Members Of The Subcommittee on Energy And Air Quality:

Thank you for inviting me to testify today for the National Association of State Utility Consumer Advocates (NASUCA) regarding the proposed “Energy Policy Act of 2005: Ensuring Jobs for Our Future with Secure and Reliable Energy.” I am Gerald Norlander, Executive Director of the Public Utility Law Project of New York, Inc. (PULP)¹ and Chairman of the NASUCA Electricity Committee.

NASUCA is a voluntary, national association of 44 consumer advocates in 42 states and the District of Columbia. NASUCA Members are designated by the laws of their respective jurisdictions to represent the interests of utility consumers before state and federal regulators and in the courts. Members operate independently from state utility commissions, as advocates primarily for residential ratepayers. NASUCA appreciates this opportunity to provide input to the subcommittee regarding utility consumer concerns before introduction of a new energy bill.

Some NASUCA Members are from states with traditional vertically integrated utility industry structures; others are from states like New York and Texas, where utilities sold their power plants to new owners and created single-state ISOs; others are from states whose

¹ PULP is an Associate Member of NASUCA, with offices at 90 State Street, Suite 601, Albany, New York 12207.

utilities joined with others across state lines to form large RTOs. Today, I speak on behalf of all NASUCA members in opposition to a large portion of the Electricity Title of the discussion draft of a proposed Energy Policy Act of 2005. This unified opposition reflects a national consensus of state consumer advocates that much of the bill, if enacted, would not materially advance, and could be detrimental to, the public interest and the interests of consumers. NASUCA, however, does support the provisions in the Bill that would require mandatory enforceable reliability standards throughout the transmission grid.

Statutory Rate Incentives For Transmission Facilities are Unnecessary

The proposed Energy Policy Act of 2005 bill would add a new Section 218 of the Federal Power Act requiring the Federal Energy Regulatory Commission (FERC) within one year to establish new rules for “incentive-based” rate treatments. This language appears to authorize a pending FERC proposal to increase interstate electricity transmission rate allowances which has been met with broad consumer opposition.² The pending FERC proposal is to allow automatic increases in the return on equity (ROE) for transmission investments, well beyond the level normally allowed in the development of just and reasonable rates. These ROE “adders” are intended to reward utilities for divesting control over their transmission assets to regional transmission organizations (RTOs), for outright divestiture of these assets to an Independent Transmission Company,” for construction work in progress and for new transmission facilities. Cooperating utilities will receive ROE bonuses, well above the normally calculated reasonable rate of return on equity invested, of 200 basis points - 2% - for existing transmission

² *Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid*, FERC Docket No. PL03-1-000.

facilities, and 300 basis points - 3% - for new investments in transmission. Nothing in the proposed FERC rule requires any showing that these bonus-conferring actions are cost effective, and nothing in the proposed bill places any upper limit on the rate making incentives. **In response to the FERC proposals for ROE “adders,”** NASUCA commissioned an examination of the cost and policy implications, and filed comments in the pending FERC proceeding. Those NASUCA comments, which are attached to my prior testimony in 2003 as an exhibit show that the current FERC initiative, if fully utilized by transmission owners, will cost consumers over \$13 billion, or approximately \$711 million per year for the 19 year time horizon in the FERC proposal. This is a conservative estimate of the potential cost of these investment incentives, and it virtually offsets the putative \$725 million per year benefit of forming Regional Transmission Organizations, a benefit estimate that is controversial for its optimism. The \$13 billion incentive -- which might be authorized by the bill -- is unnecessary and will provide no incremental benefit in many areas where transmission owners already have agreed to turn over control of their systems to regional transmission organizations (RTOs) or independent system operators (ISOs). **If Congress seeks to encourage national adoption of the system proposed by FERC, statutory ROE incentives may only impede that result. States that have not approved divestiture of transmission facilities owned by state-regulated utilities may be more reluctant to do so if automatic cost increases are the result, without any clear, offsetting benefits.**

The draft bill also lacks clarity on this point because the section on rate incentives concludes with a provision that all rates still must be just and reasonable. Under existing law, the FERC has ample flexibility to set appropriate, just and reasonable transmission rates without additional “incentives” prescribed by statute.

Transmission Cost Allocation

Section 219 of the draft contains detailed provisions for the pricing of transmission facilities not required for reliability purposes. Legislation prescribing a particular cost allocation formula is unnecessary. FERC possesses sufficient flexibility within its jurisdiction to fix just and reasonable rates for interstate transmission.

PUHCA Repeal

Subtitle F of the draft bill would repeal the Public Utility Holding Company Act (PUHCA). PUHCA is a statutory bulwark against reassembly of vast utility holding company empires. NASUCA has adopted the following resolution on this subject:

“in considering action affecting regulation or the structure of the electric industry, including PUHCA repeal or reform, Congress should require federal regulatory agencies to: 1) prevent abusive or preferential affiliate transactions, 2) continue oversight and protection over corporate and market structure to prevent abuses to consumers and competition, 3) disallow costs which are not prudent and reasonable from wholesale rates, 4) exercise sufficient regulatory authority to prevent ratepayers from bearing any risk of utility diversification and to prohibit cross-subsidies between regulated and nonregulated subsidiaries....”
NASUCA Resolution 1996-04, *Urging the Congress and Federal Agencies to Address Market Power as a Component of Any Federal Restructuring Action.*

The bill does not satisfy NASUCA’s criteria because it would eliminate current PUHCA ownership restrictions on foreign ownership and non geographically contiguous utilities, would limit state and federal regulatory agency access to books and records of the holding company to the costs of regulated entities, would require a showing of necessity for regulators to examine holding company books, and could make much information regarding holding company affiliate transactions, obtained in regulatory proceedings, confidential. The proposed requirement for state

commission findings of necessity before holding company affiliate data is made available could delay, if not bar altogether, timely rate case discovery of utility records normally available to state consumer advocates in rate proceedings without prior litigation and without state commission **“findings” that the records are necessary or related to costs.** The Enron debacle illustrates the recurring tendency of holding companies in financial trouble to look to regulated affiliates as a source of credit, cash, or other resources, all at the expense of captive utility consumers. PUHCA remains an essential consumer protection which should be vigilantly enforced, not repealed.

FERC Merger Review Authority

Some parties have urged repeal of FPA Section 203, which provides for FERC review of electric utility mergers. The draft in Section 1291 commendably retains FERC powers to review mergers continues such authority but alters the standard for review and allows for fast-tracking of FERC review and approval. There is a growing understanding that the nature of electricity and evolving electricity markets may permit the subtle exercise of market power, even without overt collusion, by entities having market shares typically allowed in other industries by the Department of Justice and the FTC. Many of the benefits projected by the FERC in its efforts, at significant expense, to create broader geographic markets for electricity rest upon the assumption that market power or flaws in existing markets will be mitigated if buyers can find more sellers in expanded regional trading areas. If, however, utility industry mergers and consolidation are allowed to occur simultaneously even as costly transmission expansions are undertaken to facilitate larger geographic marketing areas, the mergers could result in a shrinkage of the number of sellers, and a corresponding re-concentration or reappearance of market power. FERC should have authority to

scrutinize and reject proposed electric industry mergers under evolving standards for measuring market power in electricity markets.

Market Transparency, Contract Sanctity, Anti-Manipulation, Enforcement

NASUCA is concerned that electricity rates at the wholesale level may at times be vulnerable to the exercise of market power, without effective remedies for consumers. There is a widespread concern that the FERC may lack certain powers needed to broaden its activities from that of a rate regulator to that of a market regulator, capable of supervising markets effectively and able to effectuate full remedies for consumers injured by the exercise of market power or unreasonable market rates.³ In 2002, NASUCA adopted a detailed resolution supporting effective monitoring of such markets where they have been approved by the FERC.⁴

The “market transparency” provisions in Section 1281 of the draft actually authorize FERC to grant “exemptions” from existing transparency and sunshine principles long embodied in Section 205 of the FPA regarding public rate filing, notice of rate changes, and public inspection of all rate schedules.

The draft would authorize the FERC to implement an electronic rate filing system in which all rates would be publicly accessible via electronic means. There is no impediment under

³ A GAO report questions whether the FERC’s capabilities and enforcement powers, originally designed for the traditional rate setting paradigm, are sufficient tools for an effective market overseer. *Energy Markets: Concerted Actions Needed by FERC to Confront Challenges That Impede Effective Oversight*, GAO-02-656, Table 4, 69 (June, 2002).

⁴ NASUCA Resolution, *Promoting Market Monitoring Functions Within Regional Transmission Organizations (RTOs) Whenever Such Regional Entities Are Created*, June 2002, available at

existing law, however, that prevents FERC from requiring utilities publicly to file their rates electronically; indeed, many utility filings are now made electronically.

Section 1281 of the draft also includes provisions to outlaw the specific abuse of “round-trip” trading, but they are not comprehensive enough to reach new or more novel market manipulation strategies that may not be expressly covered in the statute. For example, the bar of “round-trip” trading seems to apply only to bilateral strategies, and might not cover more complex trading gambits to manipulate rates. The refund remedy would allow refunds when commission rules are violated, but only with regard for short term sales.

Consumer Protections

NASUCA does not view customer protections as a separate item within the overall statutory framework for federal oversight of the electricity industry. Rather, the fundamental purpose of the entire Federal Power Act of 1935 is to protect customers and to assure reasonableness in the provision of a service essential to life in modern society.⁵ Accordingly, any effort to amend the FPA must address whether the proposed modifications assure real benefit to consumers, or at least maintain and not jeopardize the existing level of customer protection. From this broad perspective, the pending legislative proposals do not, in NASUCA's view, increase overall customer protection, and some measures may erode existing protections.

Some of the specific consumer remedies really add nothing to existing state measures. For example, states that allow retail utility competition quickly and effectively addressed the "slamming" issue - the unauthorized switching of providers. Accordingly, there is no need for federal legislation in this area of traditional state jurisdiction, especially when many states have not adopted retail energy competition models.

Net Metering, "Smart Metering" and Real-Time Pricing

Federal measures to require or encourage states to address net metering, "Smart Metering" and real time pricing, such as contained in Section 1251 and 1252 of the draft bill, are unnecessary. NASUCA is not opposed to net metering or to voluntary real-time pricing options. At the retail level, traditionally not an area of federal concern, states are experimenting with a variety of net metering, "smart metering" and time of use pricing methodologies for retail rates. NASUCA adopted a resolution in 2001 favoring retail rate methodologies that promote price stability and

⁵ "The Federal Power Act's primary purpose [is] protecting the utility's customers." *Electrical Dist. No. 1 v. FERC*, 774 F.2d 490, 493 (D.C. Cir. 1985)(Scalia, J).

predictability of the “default” service rates for residential customers, urging each jurisdiction which introduces competitive markets for the provision of elements of electric service to design default service rates so that:

The Default Service Provider is equipped and able to assure that the rates, terms and conditions, reliability and quality of customer service offered to such customer are no worse with such service than they would be with traditional utility service;

The rates charged by such Default Service Provider are stable and predictable over the long term and that the rates or formulas to determine such rates are approved only after appropriate notice to the public, consumers, and adequate administrative review;

The Default Service Provider shall not simply pass through wholesale spot market rates for the energy or gas commodity portion of Default Service, and shall be required to take prudent measures to provide least cost service and assure long term rate stability, through various means including but not limited to competitive bid, bilateral contract, or provider-owned generation or supplies....⁶

Accordingly, NASUCA is opposed to federal mandates for real-time pricing of electricity for residential consumers, and opposes the incorporation of volatile wholesale real-time price determinants into retail rates in states that “unbundled” their rates for generation.

Reliability Provisions Should be Enacted

At the present time, reliability standards for electric grid system, including operation of generating plants and transmission lines, are set by a voluntary organization, the North American Electric Reliability Council (NERC). In recognition that the cooperative and voluntary underpinnings of reliability standards need strengthening in a competitive

⁶ NASUCA Resolution 02-02, *Urging Jurisdictions Introducing the Competitive Provision of Electricity or Natural Gas Service to Assure the Continued Availability of Reliable Service to Customers from a Default Service Provider at Just and Reasonable Rates*, at www.nasuca.org.

environment where responsibilities for keeping the energy flowing are distributed among a larger number of grid participants, NASUCA adopted the following resolution in 1998:

WHEREAS, the reliability of the Nation's electric system is of paramount importance to the consumers represented by the members of the National Association of State Utility Consumer Advocates (NASUCA);

WHEREAS, the reliability of the Nation's electric system must not be allowed to be compromised by the current restructuring of the electric industry;

* * * * NASUCA supports efforts to develop a national reliability organization that will continue the vital functions now performed by NERC, and will do so in a manner that is competitively neutral and recognizes the paramount concerns of consumers in a reliable electric system;

* * * * NASUCA supports efforts to establish an independent Board of Directors that will govern NERC (or any successor national organization) in a competitively neutral manner that will benefit all consumers and that will not be dominated or controlled by any particular industry participant or segment;

* * * * NASUCA supports federal legislation that would clarify FERC authority to review the reliability requirements imposed by NERC (or any successor national organization) and to ensure that such requirements are adopted and implemented in a manner that benefits all consumers * * * *

NASUCA Resolution 1998-07, *Urging the Establishment of an Independent Board to Govern Electric Reliability Matters and the Enactment of Federal Legislation to Ensure FERC Jurisdiction Over the Actions of Such a Board in the Future*. With each iteration of comprehensive energy bills in recent years, NASUCA has supported reliability legislation. In addition, NASUCA has often urged, along with others, passage of standalone reliability legislation.

Since NASUCA's last testimony on this subject in March 2003, the widespread blackout of August 2003 underscored the importance of enacting measures to establish firm grid reliability standards and their enforcement. The very first recommendation of the final report of the U.S.-Canada Power System Outage Task Force issued in April 2004 is to "Make reliability standards

mandatory and enforceable, with penalties for noncompliance.”⁷ The international Task Force also called for an independent study of the relationships among industry restructuring, competition, and reliability.⁸ Such concerns over the impact of restructuring on reliability -- signaled by NASUCA in its 1998 Resolution -- are now heightened by recent evidence in a FERC proceeding that a utility power plant was deliberately shut down during the California market crisis with the apparent intent to create scarcity and drive prices up during a period when blackouts were imminent:

“In one transcript released Thursday, an Enron trader identified only as Bill called it “a good plan” to shut down a small Las Vegas power plant on Jan. 17, 2001, under the guise of “checkin’ a switch on the steam turbine.” Enron employees also suggested that their plans to exploit Western energy markets predated the meltdown of 2000 and 2001, which brought record electricity prices and emergency blackouts.”

⁷ *Final Report on the August 14, 2003 Blackout in the United States and Canada, Causes and Recommendations*, U.S.- Canada Power System Outage Task Force (April, 2004) at 140. “The U.S. Congress should enact reliability legislation no less stringent than the provisions now included in the pending comprehensive energy bills, H.R. 6 and S. 2095.” *Id.*

⁸ “DOE and Natural Resources Canada should commission an independent study of the relationships among industry restructuring, competition in power markets, and grid reliability, and how those relationships should be managed to best serve the public interest.” *Final Report on the August 14, 2003 Blackout in the United States and Canada, Causes and Recommendations*, U.S.- Canada Power System Outage Task Force (April 2004) at 148.

Tapes Reveal Enron's Power Plant Rigging - Transcripts Detail How Electricity Traders Conspired to Shut down Smooth-running Generating Facilities During the Energy Crisis, L.A. Times, Feb. 4, 2004.

In the absence of legislation, FERC within the past year issued a Policy Statement which defines compliance with NERC standards to be “Good Utility Practice” and this has been engrafted into utility tariffs. *Policy Statement on Matters Related to Bulk Power System Reliability*, FERC Dkt. No. PL 04-5 (April 19, 2004). As a result, a utility that fails to follow NERC reliability standards, for example, following instructions from grid operators, will be deemed by FERC to be violating “Good Utility Practice” and thus violating provisions of its own tariffs. It is not clear, however, that this commendable step will be sufficient. Indeed, it is significant that FERC also seeks legislative enactment of standards with enforcement provisions, notwithstanding its efforts and actions after the blackout to clarify NERC standards and to engraft compliance with them into utility tariffs.

In sum, there is general agreement among many parties with diverse interests that enactment of the reliability provisions is desirable. If it appears that enactment of an omnibus energy bill is unlikely, NASUCA urges that the reliability provisions be adopted as a stand alone measure.

Conclusion

The primary purpose of the Federal Power Act is the protection of consumers, and so proposals to change it should be measured by whether they add meaningful protections or whether they erode the existing statutory bond with consumers that all rates demanded and charged will be just and reasonable. The reliability measures have merit and should be

enacted. Taken as a whole, however, the remainder of the draft bill does not assure demonstrable benefits or meaningful added protection that would make its enactment into law a value proposition for consumers.

The bill may increase consumer rates unnecessarily by prescribing rate increases for electricity transmission lines and facilities beyond a level that is just and reasonable. FERC already possesses sufficient flexibility to set rates for transmission and to determine how rate burdens will be allocated. The bill alludes to deregulated market-based rates and private market rate setting mechanisms, as substitutes for the existing bond of the FPA that no rate will be charged that is not subject to FERC review for reasonableness before it is charged. Yet the bill does not establish any criteria for FERC to follow when granting or denying market-based rates, it does not grant FERC or any other body sufficient market oversight powers, and it does not provide full remedies to consumers when there is market abuse or rate manipulation. In light of recent instances of energy market manipulation, holding company abuses, FERC's inability to provide timely and complete consumer refunds and remedies when the market rates it has allowed are unreasonable, and the possibility of further industry consolidation, it is clear that consumers need greater, not less, statutory protection from the exercise of utility market power. For these reasons, NASUCA concludes that other than the reliability provisions, the proposals to modify the Electricity title of the FPA now under consideration are not in the interests of utility consumers.

I want to thank Chairman Hall and the committee again for permitting me to share NASUCA's views on these important issues. I would be pleased to address any questions you may have at this time.

